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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

—v.—

SCIENTIFIC-ATLANTA, INC., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF THE LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION, NEW YORK CITY BOARD OF EDUCATION RETIREMENT SYSTEM, NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM, NEW YORK CITY FIRE DEPARTMENT PENSION FUND, NEW YORK CITY POLICE PENSION FUND, NEW YORK CITY TEACHERS' RETIREMENT SYSTEM, CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS, AND THE CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF AMICI CURIAE[1]

This brief is filed by public pension systems that invest billions of dollars in U.S. capital markets to fund obligations to their beneficiaries and, therefore, have a strong interest in the integrity of the securities markets and the elimination of fraud in such markets. These public pension funds believe that the scope of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), should be interpreted so as to achieve Congress's intention of eliminating deceptive practices in the purchase or sale of securities.

The Los Angeles County Employees Retirement Association ("LACERA") is the largest county retirement system in the United States, with 147,000 members and $35 billion in assets.

The New York City Employees' Retirement System ("NYCERS"), in existence since 1920 and one of the largest public pension funds in the United States, has a rich history of shareholder activism and *amicus* involvement in corporate governance issues. *See, e.g., New York City Employees' Retirement System v. S.E.C.*, 45 F.3d 7 (2d Cir. 1995); *New York City Employees' Retirement System v. Dole Food Co.*, 969 F.2d 1430 (2d Cir. 1992); *New York City Employees' Retirement System v. American Brands, Inc.*, 634 F. Supp. 1382 (S.D.N.Y. 1986). NYCERS is a public employee retirement system established pursuant to Section 130-102 of the Administrative Code of the City of New York that provides retirement, disability and death benefits to certain New York City

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person or entity other than *amici* and their counsel contributed monetarily to the preparation or submission of the brief. The parties have consented to the filing of this brief and copies of their consent have been lodged with the Clerk of the Court.

employees. NYCERS has over 300,000 active and retired participants and total plan assets of over $40 billion.

The New York City Board of Education Retirement System ("BERS") provides pension benefits to approximately 35,000 active and retired members, comprised mainly of non-pedagogical employees of the New York City Department of Education. Its plan assets exceed $2.3 billion.

The New York City Teachers' Retirement System ("TRS") provides a retirement program for some 150,000 active and retired participants who work, or have worked, for the New York City Department of Education, New York City Charter Schools or the City University of New York. TRS' basic qualified pension plan has some $40 billion in assets. In addition, the System administers a Section 403(b) tax-deferred annuity program, with more than $15 billion in assets.

The New York City Fire Department Pension Fund ("FDPF") is a single-employer public employee retirement system serving full-time uniformed employees of the New York City Fire Department. FDPF has approximately 11,500 active members and 15,700 retired members, including widows and beneficiaries. Its assets exceed $7 billion.

The New York City Police Pension Fund ("PPF"), in existence since 1857, was the first municipal retirement system established in the United States. It initially provided lump sum benefits for New York City policemen injured in the line of duty, and expanded some twenty years later to provide half pay retirement benefits to retired policemen. PPF currently administers benefits for approximately 74,000 active and retired members; the

plan assets, including variable supplement funds, are approximately $15 billion.

The Connecticut Retirement Plans and Trust Funds ("CRPTF") invests assets on behalf of public employees in the State of Connecticut. With over $20 billion in assets under management, CRPTF consists of six pension funds and eight trust funds, representing, among others, approximately 160,000 teachers, police officers, firefighters, and other state and municipal employees who are pension plan participants and beneficiaries.

The California Public Employees' Retirement System ("CalPERS") is the largest public pension fund in the United States. It manages pension and health benefits for more than 1.5 million California public employees, retirees, and their families. CalPERS manages over $247 billion in total investments.

In the aggregate, U.S. public pension plans cover more than 14 million workers and 6 million retirees and other beneficiaries and have assets of more than $2 trillion.[2]

The *amici*'s overriding responsibility is to invest for the long-term security of their millions of active and retired members. As major investors with long-term outlooks, the *amici* are vitally concerned with the proper and efficient functioning of U.S. capital markets, and are particularly concerned that investors not be harmed by fraudulent conduct. Many state and local governments are constitutionally obligated to guarantee defined benefit retirement plans. Therefore, investment losses due to securities fraud fall directly on state and local governments and ultimately on taxpayers. If public pension

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[2] *See* Gary W. Anderson & Keith Brainard, *Profitable Prudence: The Case for Public Employer Defined Benefit Pension Plans*, 1 (Pension Research Council Working Paper 2004-6, 2004), *available at* http://rider.wharton.upenn.edu/~prc/PRC/WP/WP2004-6.pdf.

funds are prevented from recovering money lost to securities fraud, the public will suffer.[3]

In recent years, public pension funds have become increasingly concerned about the integrity of U.S. securities markets. Scandals at Enron, WorldCom, Global Crossing, Tyco, Refco, Fannie Mae, Freddie Mac, Adelphia, Xerox, and numerous other public companies have caused hundreds of billions of dollars in losses to innocent investors. As investors who have been materially harmed by corporate fraud, *amici* have strong interests in ensuring that the law allows injured investors to recover from perpetrators of fraud.

The *amici* strongly believe that investors' ability to redress corporate wrongdoing through private actions under the Securities Exchange Act of 1934 is essential to deter improper conduct and to recoup losses caused by fraud. Indeed, with the Private Securities Litigation Reform Act ("PSLRA"), Congress sought "to increase the likelihood that institutional investors will serve as lead plaintiffs," based on its belief "that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions." H.R. Conf. Rep. 104-369, 1995 U.S.C.C.A.N. 730, 733. Following the passage of the PSLRA, *amici* here have served as lead plaintiffs in numerous cases, including *Leech v. Brooks Automation, Inc.*, No. 06-11068-RWZ, 2006 U.S. Dist. LEXIS 90153

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[3] In 2005, investment earnings accounted for 74 percent of all public pension plan revenue and employer (*i.e.*, taxpayer) contributions for only 17 percent. *See* National Association of State Retirement Administrators, *Key Facts Regarding State and Local Government Defined Benefit Retirement Plans*, (Jan. 2007), http://www.nasra.org/news/article.asp?newsid=112) (follow "Access the Key Facts document" hyperlink).

(D. Mass. Dec. 13, 2006) (LACERA); *In re JDS Uniphase Corp. Securities Litigation*, No. C 02-1486 CW, 2006 U.S. Dist. LEXIS 18872 (S.D. Cal. April 6, 2006) (CRPTF); *In re Enterasys Networks, Inc., Securities Litigation*, No. 02-071-M, 2002 U.S. Dist. LEXIS 15450 (D.N.H. Aug. 2, 2002) (LACERA); *In re Waste Management, Inc.*, 128 F. Supp. 2d 401 (S.D. Tex. 2000) (CRPTF); *In re Orbital Sciences Corp. Securities Litigation*, 187 F.R.D. 246 (E.D. Va. 1999) (BERS, NYCERS and FDPF); and *In re Cendant Corp. Litigation*, 182 F.R.D. 144 (D.N.J. 1998) (CalPERS).[4]

Before 1995, settlements for more than $20 million were unusual, and settlements of $100 million or more were exceedingly rare. Since 1995, seven cases have settled for more than $1 billion and more than 20 cases have settled for more than $100 million. Recoveries have reached unprecedented levels because of the cases' merit and institutional investor leadership.[5] At the same

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[4] The *amici*, as long term investors, also have an interest in preventing meritless, lawyer-driven litigation. As one of many ways the PSLRA discourages meritless cases, the statute's "professional plaintiff" provision bars a plaintiff from serving as lead plaintiff in more than five actions filed within three years, except as permitted by the court. *See* 15 U.S.C. § 78u-4(a)(3)(B)(vi). Notably, Congress gave courts discretion to allow "[i]nstitutional investors seeking to serve as lead plaintiff . . . to exceed this limitation [because they] do not represent the type of professional plaintiff this legislation seeks to restrict." H.R. Conf. Rep. 104-369, 1995 U.S.C.C.A.N. 730, 734.

[5] In the article that inspired the lead plaintiff provisions of the PSLRA, *see* S. Rep. 104-98, 1995 U.S.C.C.A.N. 679, 690 n.32, Professors Weiss and Beckerman predicted that "[t]he largest benefit of institutional supervision of class actions is likely to be settlement terms that are more favorable to the plaintiff class, on average, than those now negotiated by essentially unsupervised plaintiffs' attorneys." Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2121 (1995). Their prediction has been fulfilled, exactly as Congress intended.

time, a much larger percentage of suits filed since enactment of the PSLRA has been dismissed under the PSLRA's stringent pleading requirements.[6] Reflecting the PSLRA's deterrence of meritless cases, securities class action filings "plunged to a record low in 2006."[7]

SUMMARY OF ARGUMENT

Section 10(b)'s prohibition on the use of any "deceptive device or contrivance" should be construed in accordance with the plain language of the statute. This language does not require that a defendant make a misrepresentation or omission in order for liability to attach. The statutory language merely requires deception, which can be accomplished by conduct as well as by statements or omissions. Where a defendant engages in conduct with the purpose and effect of deceiving investors as part of a scheme to defraud, that constitutes the use of a deceptive device within the meaning of § 10(b).

Such construction of Section 10(b) is confirmed by the Securities and Exchange Commission's adoption of Rule 10b-5, 17 C.F.R. § 240.10b-5, pursuant to the Congressional authorization contained in Section 10(b). Rule 10b-5(a) prohibits any "scheme . . . to defraud," and Rule 10b-5(c) prohibits any "course of business which operates or would operate as a fraud or deceit upon any person." As this Court has recognized, these provisions

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[6] *See* Todd Foster et al., NERA Economic Consulting, *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar*, 4 (Jan. 2007), *available at* http://www.nera.com/image/BRO_Recent_Trends_SEC1288_FINAL_0307.pdf.

[7] Cornerstone Research, *Securities Class Action Case Filings: 2006: A Year in Review*, 1 (2007), available at http://securities.cornerstone.com/pdfs/YIR2006.pdf.

clearly do not require the making of misleading statement or omission. *See Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152-54 (1972). The S.E.C.'s longstanding understanding of the scope of Section 10(b) as reflected in Rule 10b-5 is entitled to deference.

Furthermore, on numerous occasions subsequent to the adoption of Rule 10b-5 by the S.E.C., Congress has reexamined and amended the private right of action under Rule 10b-5, but never expressed any concern that Rule 10b-5(a) and (c) went beyond the intended scope of Section 10(b). In such circumstances, Congressional approval of the way in which Rule 10b-5 implemented Section 10(b) should be presumed, and the Court should leave to Congress any change in the scope of this provision.

Finally, Congress's intent to maintain honest and efficient capital markets would be undermined if persons were allowed to escape liability when they engage in transactions whose purpose and effect is to deceive investors. There is no need for the Court to reduce the scope of Section 10(b) out of concern as to "vexatious" securities litigation. Subsequent to the enactment of the PSLRA, fewer securities class actions are being filed than in the past, and more actions are being terminated on motions to dismiss. Institutional investors are being appointed as lead plaintiffs, and previous concerns about lawyer-driven, meritless securities lawsuits have been largely addressed.

Fraud is corrosive to the economy. As this Court has recognized, there is a strong "federal interest in protecting the integrity and efficient operation" of the U.S. securities markets. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 1509 (2006). Investor confidence in the integrity of the secu-

rities markets is key to the ability of businesses to raise capital, because without such confidence, investors " 'will be less likely to invest, thereby reducing the liquidity of the securities markets to the detriment of investors and issuers alike.' " *Basic Inc. v. Levinson*, 485 U.S. 224, 235 n.12 (1988) (quoting *In re Carnation Co.*, Exchange Act Release No. 22214, 33 SEC Docket 1025, 1030 (1985)).

To maintain investor confidence in the integrity of capital markets, to enable defrauded investors to recover as much of their losses as possible, and to avoid creating a loophole through which numerous actors could evade liability despite acting with scienter to deceive investors, the Court should follow the plain language of Section 10(b) and the Court's own precedents by reversing the Eighth Circuit's holding and finding that Section 10(b) liability need not be predicated on a statement or omission.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 10(b) INDICATES THAT PARTICIPATION IN A TRANSACTION THAT HAS NO LEGITIMATE BUSINESS PURPOSE AND THAT IS DESIGNED TO MISLEAD THE INVESTING PUBLIC CAN CONSTITUTE CONDUCT VIOLATIVE OF SECTION 10(b) NOTWITHSTANDING THAT THE ACTORS THEMSELVES MADE NO PUBLIC STATEMENTS OR OMISSIONS

This Court has stressed that in attempting to determine the scope of liability under Section 10(b), the Court must "turn first to the language of § 10(b), for '[t]he starting point in every case involving [the] construction of a statute is the language itself.' " *Ernst & Ernst v.*

Hochfelder, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975)). Analysis of the language of Section 10(b) shows that it encompasses deceptive conduct regardless of whether the actor makes any statement or omission.

Section 10(b) makes no reference to statements or omissions, but rather contains a broad prohibition against the use of any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe."[8] Deception can be achieved in numerous ways other than through false or misleading statements, and nothing in the statutory language requires that the defendant make a misrepresentation or omission in order for liability to attach under the section. This Court has noted that "device" means "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice," and that "contrivance" means "[a] thing contrived or used in contriving; a scheme, plan, or artifice." *Hochfelder*, 425 U.S. at 199 n.20 (quoting Webster's International Dictionary (2d ed. 1934)). As noted in *In re*

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[8] Section 10(b), 15 U.S.C. § 78j(b), provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Parmalat Securities Litigation, 376 F. Supp. 2d 472, 502 (S.D.N.Y. 2005), the same dictionary upon which the Court relied in *Hochfelder* defines "deceptive" as "[t]ending to deceive; having power to mislead."

Under these definitions, conduct that has the purpose and effect of creating a false impression can constitute a "deceptive device or contrivance" even if the actor does not make any statement. As the Ninth Circuit held in *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1052 (9th Cir. 2006): "We conclude that conduct by a defendant that had the principal purpose and effect of creating a false appearance in deceptive transactions as part of a scheme to defraud is conduct that uses or employs a deceptive device within the meaning of § 10(b)." *See also Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, No. 06-20856, 2007 WL 816518, at *22 (5th Cir. Mar. 19, 2007) (Dennis, J., concurring in the judgment) ("a deceptive act includes a transaction whose principal purpose and effect is to create a false appearance of revenues, which can be accomplished by acts as well as by words") (quoting *In re Enron Corp. Securities, Derivative & ERISA Litigation*, No. H-01-3624, 2006 U.S. Dist. LEXIS 43146, at *167-74 (S.D. Tex. June 5, 2006)).

Such interpretation of the statutory language of Section 10(b) is particularly apt in light of this Court's consistent teaching that "securities laws combating fraud should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.' " *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (quoting *S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). In particular, the Court has stated that Congress intended Section 10(b) and Rule 10b-5 to enjoy a broad interpretation insofar as the question of what constitutes deception or

a fraudulent scheme within their scope is concerned. In *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), which involved a complicated series of transactions whereby the defendant purchased a corporation's stock with the corporation's own assets, the Court held that the plaintiff stated a claim under Section 10(b) and Rule 10b-5 because there "was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated as 'a fraud or deceit' " on the seller of securities. *Id.* at 9. The Court further stated:

> We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.

Id. at 11 n.7 (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)). If the scope of Section 10(b) were limited to situations where the defendant made a misrepresentation, it is doubtful the Court would have used the above-quoted language or reached the result it did.

Because a person employing a deceptive device or contrivance commits a primary violation of Section 10(b), liability for such conduct is not barred by this Court's decision in *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 191 (1994), that there is no private civil claim for aiding and abetting a Section 10(b) violation. In *Central Bank*, the plaintiffs conceded that the defendant "did not commit a manipulative or deceptive act within the meaning of § 10(b)" and therefore the question of what constitutes a primary violation of the statute was not at issue. *Id.; see Credit Suisse First Boston*, 2007 WL 816518, at *21 (Dennis, J., con-

curring in the judgment).[9] Additionally, in *Central Bank*, the Court expressly recognized that so-called "secondary actors" are subject to liability under Section 10(b) when they commit primary violations of that statute, including violations involving acts other than the making of false statements:

> The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device *or* makes a material misstatement (or omission) on which a purchaser . . . relies may be liable as a primary violator under 10b-5 . . . . In any complex securities fraud, moreover, there are likely to be multiple violators. . . .

Central Bank, 511 U.S. at 191 (emphasis added).

Subsequent to *Central Bank*, this Court has continued to recognize that liability under Section 10(b) need not be premised on false or misleading statements but rather can be based upon a defendant's commission of deceptive acts or participation in a fraudulent scheme. In *S.E.C. v. Zandford*, 535 U.S. 813 (2002), this Court reversed the dismissal of a Rule 10b-5 claim against a broker who had converted proceeds from sales of his customers' securities to his own use, even though the broker was "able to carry out his fraudulent scheme

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[9] *See also In re Parmalat Sec. Litig.*, 376 F. Supp. 2d at 493 (*Central Bank* "did not change the scope of Rule 10b-5 or what constitutes a primary violation of it"); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 171 (D. Mass. 2003) (in *Central Bank* "[t]he Supreme Court did not reach the issue of the extent to which participants in a securities fraud scheme are primary violators of § 10(b).").

without making an affirmative misrepresentation," *id.* at 822, because allegations that he had "engaged in a fraudulent scheme" and a "course of business that operated as a fraud or deceit" were sufficient to state a claim. *Id.* at 820-21.[10]

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[10] Numerous cases in the lower courts similarly have upheld claims under Section 10(b) based on the defendants' participation in fraudulent schemes. While the exact formulations have differed, the central theme is that Section 10(b) reaches deceptive conduct and not merely misstatements or omissions. *See Benzon v. Morgan Stanley Distrib.*, 420 F.3d 598, 610 (6th Cir. 2005) ("Rules 10b-5(a) and (c) encompass conduct beyond disclosure violations . . . . We therefore conclude that the district court's determination that Defendants complied with their disclosure obligations does not dispose of Plaintiffs' claims under Rule 10b-5(a) and (c)"); *S.E.C. v. U.S. Envtl., Inc.*, 155 F.3d 107, 111 (2d Cir. 1998) ("a primary violator is one who 'participated in the fraudulent scheme' or other activity proscribed by the securities laws"); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d at 506 (Section 10(b) claim upheld where the banks' conduct "created the appearance of revenue or assets where there was none and thus distorted the prices of Parmalat's securities"); *WM High Yield Fund v. O'Hanlon*, No. 04-3423, 2005 WL 1017811, at *8 (E.D. Pa. Apr. 29, 2005) ("given the massive fraudulent scheme set forth by Plaintiffs in their Complaint . . . it appears that they have set forth sufficient facts to survive a Motion to Dismiss as to all Defendants on the basis of Rule 10b-5(a)/(c) liability"); *Quaak v. Dexia, S.A.*, 357 F. Supp. 2d 330, 338 (D. Mass. 2005) ("Plaintiffs have alleged a primary violation of Rule 10b-5 by defendant through its participation in a manipulative or deceptive scheme intended to mislead investors."); *In re AOL Time Warner Sec. & ERISA Litig.*, 381 F. Supp. 2d 192, 217 (S.D.N.Y. 2004) (claim stated under Section 10(b) where it was alleged that defendants "engaged in a systematic scheme . . . to inflate AOL's reported advertising revenue . . . based on various sham transactions . . . ."); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 335 (S.D.N.Y. 2004) ("a cause of action exists under subsections (a) and (c) [of Rule 10b-5] for behavior that constitutes participation in a fraudulent scheme, even absent a fraudulent statement by the defendant"); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d at 173 ("any person who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative

The court below relied on *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), for the proposition that deceptive conduct must involve "either a misstatement or a failure to disclose by one who has a duty to disclose." *In re Charter Communications, Inc. Securities Litigation*, 443 F.3d 987, 990 (8th Cir. 2006). *Santa Fe*, however, involved the question of whether a garden variety breach of fiduciary duty constituted a violation of Rule 10b-5 and did not address the contours of scheme liability under Section 10(b). It is, therefore, not dispositive of the issue at bar. Nevertheless, the language that the Court employed in *Santa Fe* refutes the proposition for which the Eighth Circuit cited it. In *Santa Fe*, the Court explained that the Court's prior cases all "included some element of deception," and did not "support the proposition . . . that a breach of fiduciary duty by majority stockholders, without any *deception, misrepresentation, or nondisclosure*, violates the statute and the Rule." 430 U.S. at 475-76 (emphasis added). As Judge Dennis observed in his concurring opinion in *Credit Suisse First Boston,* by referring to deception separately from misrepresentations and nondisclosures, the Court's language in *Santa Fe* "affirmatively indicates that 'deceptive' conduct need not always be in the form of a misrepresentation or an omission." 2007 WL 816518, at *21.

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or deceptive device (like the creation or financing of a sham entity) intended to mislead investors, even if a material misstatement by another person creates the nexus between the scheme and the securities market" is liable under Section 10(b)); *In re Williams Sec. Litig.*, 339 F. Supp. 2d 1206, 1237 (N.D. Okla. 2003) (complaint sufficiently alleged primary Rule 10b-5 liability based on participation in scheme to defraud); *Rich v. Maidstone Fin., Inc.*, No. 98-2569, 2002 WL 31867724, at *8 n.6 (S.D.N.Y. Dec. 20, 2002) ("the Second Circuit continues to permit plaintiffs to allege 'participation in' a securities fraud scheme as one manner in which a plaintiff may state a claim under § 10(b) and Rule 10b-5.").

Moreover, in *Santa Fe*, the Court also stated that "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices" when it enacted Section 10(b). 430 U.S. at 477. It would be inconsistent with this Congressional intent to remove from the scope of Section 10(b) claims against persons who engage in transactions that lack legitimate business purpose and are designed to deceive the investing public. Indeed, as Professor John Coffee recently observed, if the decision below is affirmed, effectively "the gatekeepers should be able to go back to sleep." John C. Coffee, Jr., *Future of Class Actions Depends on Pending Cases*, N.Y. Law Journal, Mar. 27, 2007, at 5. That cannot be what Congress intended, given the Congressional intent underlying Section 10(b) "to insure honest securities markets and thereby promote investor confidence." *Zandford*, 535 U.S. at 819 (quoting *United States v. O'Hagan*, 521 U.S. 642, 658 (1997)).

II. THE S.E.C.'S LONGSTANDING INTERPRETATION OF SECTION 10(b) AS REFLECTED IN RULE 10b-5 IS ENTITLED TO DEFERENCE

That Section 10(b) encompasses deceptive conduct beyond mere misrepresentations or omissions is reinforced by the language of Rule 10b-5(a) and (c). In Section 10(b), Congress specifically made it unlawful for any person "to employ any deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to this authorization, in 1942 the Securities and Exchange Commission promulgated Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instru-

> mentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

Only subpart (b) requires a misstatement or omission by the defendant; subparts (a) and (c), which proscribe any scheme to defraud or any conduct which operates as a fraud or deceit, on their face clearly do not. *See Affiliated Ute*, 406 U.S. at 152-53 ("To be sure, the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted."). *See also Benzon*, 420 F.3d at 610 ("A plain-language reading" of Rule 10b-5 supports the view that "a defendant not liable under Rule 10b-5(b) for failure to disclose . . . may still be held liable under Rule 10b-5(a) and Rule 10b-5(c) as a participant in [an] allegedly fraudulent scheme") (internal quotation marks omitted).

Of course, the scope of Rule 10b-5 "cannot exceed the power granted the Commission by Congress under § 10(b)." *Hochfelder*, 425 U.S. at 214. However, as discussed above, Section 10(b) leaves it to the S.E.C. to promulgate rules defining the parameters of Section 10(b)'s prohibitions, "as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). In such circumstances, the S.E.C.'s construction of § 10(b) as reflected in Rule 10b-5 is entitled to deference. As stated in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984) (internal citations omitted):

> [I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.
>
> "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.

See also Rapanos v. United States, 126 S. Ct. 2208, 2235-36 (2006) (Roberts, C.J., concurring) ("Agencies delegated rulemaking authority under a statute . . . are

afforded generous leeway by the courts in interpreting the statute they are entrusted to administer.").

In the exercise of the rulemaking authority that Congress delegated to it in Section 10(b), the S.E.C. determined that it was appropriate to prohibit fraudulent schemes and practices that would operate as a fraud. Such interpretation and rulemaking by the S.E.C. are reasonable and therefore entitled to deference.[11]

III. BECAUSE CONGRESS CHOSE NOT TO RESTRICT THE BROAD SCOPE OF RULE 10b-5(a) AND (c) WHEN IT REEXAMINED THE PRIVATE CIVIL RIGHT OF ACTION UNDER SECTION 10(b), THIS COURT SHOULD NOT DO SO EITHER

Rule 10b-5 was adopted in 1942, and since that time Congress has on several occasions reexamined and amended the provisions of the Securities Exchange Act bearing on the implied private right of action under Rule 10b-5, most recently in 2002 when it passed the Sarbanes-Oxley Act and previously in 1995 and 1998 when it passed the PSLRA and the Securities Litigation Uniform Standards Act ("SLUSA"), respectively. These were not mere amendments to the Securities Exchange Act in general, but rather focused directly on the private right of action under Rule 10b-5, addressing such mat-

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[11] There are, of course, limits on the deference due the S.E.C. with respect to Rule 10b-5. In *Hochfelder*, for example, this Court held that the S.E.C.'s view that negligent conduct violated Rule 10b-5 was not reasonable given that Section 10(b) specifically referred to manipulation and deception—"the commonly understood terminology of intentional wrongdoing." 425 U.S. at 214. Here, by contrast, the S.E.C.'s view as expressed in Rule 10b-5(a) and (c) that Section 10(b) can be violated by deceptive conduct or participation in a fraudulent scheme does not run afoul of any words in Section 10(b).

ters as the pleading standards, loss causation, damages, statutes of limitation, jurisdiction, proportionate liability, and contribution rights. *See* 15 U.S.C. § 78u-4; 15 U.S.C. § 78bb(f); 28 U.S.C. § 1658(b).

These reexaminations and amendments left intact the provisions of Rule 10b-5(a) and (c). Under such circumstances, Congressional approval of the S.E.C.'s implementation of Section 10(b) as manifested in Rule 10b-5, as well as this Court's interpretation of Rule 10b-5 as expressed in *Affiliated Ute* and *Superintendent of Insurance*, should be presumed, and it should be left to Congress to make any change in the scope of Section 10(b) as implemented by Rule 10b-5. As this Court stated in *Barnhart v. Walton*, 535 U.S. 212, 220 (2002), Congressional reexamination of a statutory provision with knowledge of the relevant agency's interpretation thereof provides evidence "that Congress intended the Agency's interpretation, or at least understood the interpretation as statutorily permissible." *See also Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 420 (1986) ("Congress must be presumed to have been fully cognizant of [judicial] interpretation of the statutory scheme, which had been a significant part of our settled law for over half a century, and that Congress did not see fit to change it when Congress carefully reexamined this area of law"); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 381-82 (1982) (Congressional amendment and reenactment of the Commodities Exchange Act without eliminating judicially created private right of action reflects Congressional approval of such right).

IV. REVERSAL OF THE DECISION BELOW WOULD FURTHER THE STRONG CONGRESSIONAL POLICY OF STRENGTHENING THE INTEGRITY OF SECURITIES MARKETS AND PROTECTING INVESTORS

As this Court long has recognized, private securities litigation is a valuable part of the overall enforcement regime that compensates defrauded investors, deters fraud, promotes investor confidence and facilitates the fair and efficient functioning of our capital markets. "The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 1509 (2006). "[P]rivate enforcement" of Rule 10b-5 provides "a necessary supplement to Commission action." *Blue Chip Stamps*, 421 U.S. at 730.

There is no need for the Court to strain to excuse from liability persons engaged in fraudulent conduct out of any concern over what the Court previously has characterized as "vexatious" securities litigation. *See, e.g., Blue Chip Stamps*, 421 U.S. at 743. As Professor John Coffee noted recently, "under the PSLRA this problem may have subsided." John C. Coffee, Jr., *supra*, at 5. Indeed, the facts indicate that the PSLRA has already achieved Congress's intent to remedy perceived abuses in private securities litigation. Since 1995, the dynamics of securities class actions, especially cases involving large investor losses, have changed radically. Institutional investors have come to the fore in most such cases, seeking appointment as lead plaintiffs, pressing counsel to prosecute class members' claims vigorously, and negotiating lower attorney fees, as a percentage of recoveries, than was typical before the PSLRA. Poten-

tially frivolous cases no longer pose the problems that previously worried courts, while meritorious cases have gained prominence in response to recent outbreaks of corporate wrongdoing.

Based upon the most recent evidence, under the PSLRA, recoveries have increased, the number of lawsuits filed has substantially declined, and the dismissal rate has jumped. The most recent study by NERA Economic Consulting, whose work was cited by Congress when debating the PSLRA, found that in 2006, federal securities class action filings dropped 36% from 2005 and 44% from the overall post-PSLRA average. *See* Todd Foster et al., *supra* note 6 at 2. A similar study by Cornerstone Research found a 49% decline from 2005 and a 53% decline from the historic average. *See* Cornerstone Research, *supra* note 7, at 1. Moreover, NERA reports that "the probability of a company facing a suit that survives a motion to dismiss has fallen by more than 30%," and that the probability of a shareholder class action in the first place has dropped nearly 10%. Todd Foster et al., *supra* note 6, at 3. Dismissal rates have doubled since the passage of the PSLRA. *See id.* at 4. On the other hand, with regard to settlement value, NERA reports:

> This year will stand out as one of record settlements. There were more settlements over $100 million—the so-called mega-settlements—in 2006 than in 2005, itself a record-breaking year.

Id. at 1.

Thus, fewer cases are being filed, and those that proceed to discovery are much stronger, resulting in larger recoveries for plaintiffs. Private securities litigation has proven itself a valuable tool in the protection of

investors and the deterrence of securities fraud, and no policy reason exists to allow persons who participate in transactions designed to mislead investors to escape liability under Section 10(b). Indeed, such a result would do great harm to investor interests, as it would leave them with no viable means to recover damages sustained as a result of even intentionally deceptive conduct, so long as the wrongdoer avoids making a false statement or assuming a duty of disclosure. Given the complexity of corporate frauds, this will create a significant and unwarranted loophole in Rule 10b-5.

Elimination of any claim under Section 10(b) based on deceptive schemes to defraud would likely result in some plaintiffs bringing comparable claims under state law in state court. While under SLUSA such claims could not be brought as class actions, preventing small investors, as a practical matter, from obtaining relief, large investors with large individual claims might still find such a course of action feasible.[12] Such a migration of claims to the state courts, with varying substantive and procedural law, was precisely what Congress sought to prevent when it adopted SLUSA.

Preventing fraud in the purchase or sale of securities furthers the interests of both investors and honest businesses, because investor confidence in the integrity of the securities markets is crucial to helping businesses raise the capital that they require. *See Basic Inc. v. Levinson*, 485 U.S. 224, 235 n.12 (1988). By seriously impairing the ability of investors to recover for fraud,

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[12] In the wake of the Fifth Circuit's decision restricting the scope of Rule 10b-5(a) and (c) in *Credit Suisse First Boston*, 2007 WL 816518, numerous state court suits by large investors are expected. *See* Carrie Johnson, *Investors Defeated in Enron Decision; Investment Banks Ruled Not Liable*, Wash. Post, Mar. 20, 2007, at D01.

the decision below is damaging not only to investors but to also to legitimate businesses that need to resort to the capital markets.

CONCLUSION

It is respectfully submitted that the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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